# ST 01-0030-PLR 07/25/2001 COMPUTER SOFTWARE

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See enclosed copy of Section 130.1935. (This is a PLR).

July 25, 2001

## Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 III. Adm. Code 1200 (see <a href="http://www.revenue.state.il.us/legalinformation/regs/part1200">http://www.revenue.state.il.us/legalinformation/regs/part1200</a>), is in response to your letter of April 30, 2001 and fax of requested materials on July 17, 2001. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to TAXPAYER for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither TAXPAYER nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

We are writing on behalf of our client, TAXPAYER ('Taxpayer') to request a Private Letter Ruling ('Ruling') from the Illinois Department of Revenue ('Department') addressing the taxability of its software access and services agreement (the 'Agreement').

Taxpayer is not presently under examination by the Department, and has not been contacted by the Department regarding sales or use taxes. To the best of the Taxpayer's knowledge and our knowledge, the Department has not previously ruled on the same or a similar issue for Taxpayer, and has not submitted the same or a similar issue to the Department, withdrawing the issue before a letter ruling was issued.

#### **Facts**

Taxpayer is a new business venture aspiring to become the preeminent provider of e-business supply chain services to the industry ('Industry'). Taxpayer will provide an online transaction platform, from which members of the industry will be able to buy and sell products. Providing the online platform will allow increased efficiencies in order processing by reducing transaction costs, improving information exchange between selling partners, and reducing the number of intermediaries in the supply chain. Buyers will have more purchase options, and sellers will increase their reach and visibility to potential customers. The users will populate the trading tool software/database with pricing information, and the platform software tools will enable price negotiations and online auctions. The platform will allow bidding with specific customers (private

network) or all members (public exchange), and will also allow buyers to track orders online, benchmark and measure performance.

Taxpayer will charge customers a flat monthly or yearly subscription fee to utilize the electronic platform. Customers will include both buyers and sellers. Taxpayer will facilitate the orders among its members, but will not take title or possession of any goods.

The electronic platform will require functionality highly specific to the Industry. Taxpayer has contracted with a technology partner ('Technology Partner') to provide the core technology platform and systems integration services for the build-out of the marketplace. The Technology Partner is in the business of designing, developing and operating B2B network solutions. Each solution is tailed to meet the specific needs of complex industries. The Agreement with the Technology Partner includes various components:

- A. Subscription Fee: The subscription fee is \$\$ per year for a non-exclusive right to access the computer software in object code form, owned or distributed by the Technology Partner, which is required to operate the marketplace ('Exchange Site'). The existing software functionality will be altered pursuant to customization, or Exchange Site Development Services. The subscription fee is for one year, with annual options to renew. (See Section 2.1(a), 1.9 and 6.1 of the Agreement and Attachment B)
- B. Exchange Site Development Services: The Technology Partner will provide a team of professionals to develop the Exchange Site according to functional specifications developed by Taxpayer and the Technology Partner. The fees for Exchange Site Development are \$\$\$ per month, and are anticipated to be approximately \$\$\$, or over xx% of the subscription fee. The Taxpayer has already incurred over \$\$\$ in Exchange Site Development fees, or xx% of the subscription fee. (See Section 4.1 and 3 of the Agreement and Attachments A and B).
- C. Hosting: The Technology Partner will host the Exchange Site for \$\$ per month. (See Section 2.4 of Agreement and Attachments B and E).
- D. Additional Services: Additional engineering services and systems integration services at \$\$\$ per hour.

## Proposed Ruling

Taxpayer respectfully requests a private letter ruling indicating that the Exchange Site is custom software under Illinois rules.

## Analysis

Illinois statutes define computer software as tangible personal property. 'Computer software' includes prewritten or canned software programs, but does not include software that is adapted to specific individualized requirements of a purchaser, custom-made and modified software designed for a particular or limited use by a purchaser. 35 ILCS 120/2-25.

The Department's Regulation 86 III. Admin. Code Sec. 130.1935(c) clarifies:

Custom computer programs prepared to the special order of the customer are not subject to tax under the Retailers' Occupation Tax, Use Tax, Service Occupation Tax or Service Use Tax. To be considered exempt software, the following elements must be present:

- A. Preparation or selection of the program for the customer's use required an analysis of the customer's requirements by the vendor; and
- B. The program requires adaptation by the vendor to be used on a specific work environment, e.g., a particular make and model of a computer using a specified input or output device.

The Taxpayers' Agreement meets these requirements. An extensive analysis of the customer's requirements is being performed through the Exchange Site Development Services. During the first month of Exchange Site Development, the Taxpayer and Technology partner met to define functional and technical specifications for the Exchange Site. The specifications will be used to write the functional code that will customize the Technology Partner's software for the Industry.

The Department's regulation further states:

Custom computer programs do not include 'canned' or prewritten computer programs held for general or repeated sale or lease. Modification of an existing prewritten program to meet the customer's needs is custom software. If modified software is held for general or repeated sale or lease, it is canned software. Custom software means the software which results from real and substantial changes to the operational coding of canned or prewritten software in order to meet the specific individualized requirements of the purchaser for his limited or particular use. 86 III. Admin. Code Sec. 130.1935(c)(2).

The Department's regulation also addresses the selection of pre-written or canned programs or program modules assembled by the vendor into a software package, indicating that such assembly does not constitute custom software unless real and substantial changes are made the to programs or creation of program interfacing logic. 86 III. Admin. Code Sec. 130.1935(c)(3).

The Technology Partner developed a platform upon which custom applications may be written. While the core platform for Taxpayer's B2B marketplace was not developed specifically for Taxpayer, the custom applications were specifically written for Taxpayer.

In this section, the Department provides a financial test of whether 'substantial' changes are made:

If the pre-written program or module was previously marketed, the new program will qualify as a custom program if the price of the pre-written program was 50% or less of the price of the new program. If the pre-written program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for the custom programming services, as evidenced by the records of the seller, was more than 50% of the contract price to the consumer. 86 III. Admin. Code Sec. 130.1935(c)(3).

The Technology Partner confirms that the charge made to Taxpayer for the custom programming services was clearly more than 50% of the contract price to the consumer. As a result, the marketplace meets the tests set forth by the Department and qualifies as custom software.

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Your assistance in this matter is appreciated. If you believe that you would not find in accordance with the proposed Ruling set forth above, the opportunity to submit additional information and discuss this matter in greater detail is requested. Please call me if you have any questions.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See enclosed copy of Section 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

Based upon the terms of the Software Access and Services Agreement attached to your letter, the exchange site is custom software.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at <a href="https://www.revenue.state.il.us">www.revenue.state.il.us</a> or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Melanie A. Jarvis Associate Counsel

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